Franchise Tax Board (FTB) EDR Project Finance Letter Supplemental Materials

The Enterprise Data to Revenue (EDR) project is the Franchise Tax Board's technology modernization project that will bring in over $1 billion in additional revenue collections starting in 2016, and each year thereafter.

Implementation of this project better positions FTB to address the annual Tax Gap of over $6.5 billion by collecting taxes that are due to the State but currently unpaid or uncollected for various reasons. EDR will enable FTB to both improve its use of existing data for enforcement purposes and implement new self-help tools for taxpayers and tax practitioners to ease burdens that may currently exist related to filing a return or paying taxes due.

On March 1, 2011, FTB will submit a draft copy of a Finance Letter to the Department of Finance (DOF) regarding the EDR Project. As of March 10th, the Finance Letter remains in draft form awaiting finalization of the Special Project Report by the California Technology Agency. Due to the timing of the Board meeting, EDR project timelines, and DOF deadlines for Finance Letter submissions, this Finance Letter is not able to be presented for approval at the March 10, 2011 Board meeting and will be submitted to DOF as "Pending Board Approval." With this Finance Letter, we are requesting an increase in EDR project funding and position authority beginning in fiscal year 2011/12.

The additional funding reflects the costs associated with the solution proposed by the Primary Solution Provider (PSP). As anticipated in this type of procurement, the solution proposed by the PSP to address the goals outlined by the EDR project differed somewhat from FTB's initial cost estimates. After careful review of the PSP proposed solution, we recognized that the increased project cost will provide additional revenue streams and earlier revenue than originally forecast. As a result, we will request an increase in resources associated with the project. This Finance Letter represents the third year of the EDR Project and includes the first year of the PSP contract.

EDR Project Revenue

Additional Revenue Due to Augmentation Request
Revenue generated from this augmentation request is anticipated to be:
- $65.3 million in General Fund revenues for FY 2011/12.
- $150.7 million in General Fund revenues for FY 2012/13.

This is an increase of $37.4 million in General Fund revenues in FY 2011/12.

Ongoing Revenue
The State will start to see EDR project revenues in FY 2011/12. EDR revenue will continue to increase over the course of project development, leveling out at additional annual General Fund revenue collections of $1 billion starting in 2016. This is the collection of tax liabilities due to the State but currently unpaid or uncollected for various reasons.

The EDR Project is a solution based procurement model to acquire a best value, business driven and innovative solution. This model is based on acquiring innovative solutions to strategic business problems that when solved result in increased tax revenues. Under this model, the contractor is compensated only when the new tax revenues are realized and after certain State costs have been recouped. Revenue benefits over and above these amounts are shared with the contractor based on a fixed price contract. In this way, the project budget is constructed so that the State does not incur out-of-pocket expenses to compensate the contractor. This procurement model also reduces risk to the state from the project since payment is only due after tangible monetary benefits to the state are achieved.

The majority of EDR project infrastructure and OE&E costs are front loaded into FY 2011/12 as State and contractor staff and required equipment are brought in to work on the EDR solution. This one-time investment will last the life of the project.

Reasons for Augmentation

In order to be successful in obtaining a benefits funded contract and meet the control agencies' requirements for a successful project, the department requires an augmentation to fund the following four areas.

1. *Compensation Payments to the PSP*
   Due to the Benefits Based Payment Model used by the project, payments to the contractor or PSP are based on the benefits (revenue) that the State receives. This approach shifts much of the financial risk to the contractor. Project revenue and schedule have been updated to reflect greater revenue amounts that are coming in a year sooner based on the PSP's solution. The estimated PSP payment for FY 2011/12 is $24.97 million.

2. *Additional Permanent IT Positions and Adjustment of Compliance Positions*
   The EDR Project will require IT resources with specific knowledge, skills and abilities. Additionally, the total number of State compliance resources is now less than the total projected in the FSR, but the business areas and timing of these resources has changed, requiring some of the resources to be moved up earlier in the project.

3. *Independent Verification and Validation (IV&V) Contractor Services*
   As required by SIMM Section 45, the Independent Verification and Validation (IV&V) vendor will oversee and perform verification and validation including quality assurance of the EDR Project contractor and State activities to verify execution consistent with project requirements. These costs are also recouped from benefits generated.

4. *Cost Reasonableness Consultant Services*
   Due to the complexity of the EDR Project, cost reasonableness analysis will be needed at various times during the first 36 months of the contract. A contract of this length will likely require contractual changes over the course of the project due to a variety of reasons, including potentially significant tax law or other legislatives changes that affect the way FTB administers tax law. To ensure the State receives a fair cost estimate for these unforeseen changes, a cost reasonableness consultant will be needed to initially set up a cost evaluation tool and process independent of both the State and the PSP.

Risk Related to Restrictions on Resources

FTB remains concerned regarding ongoing and future restrictions on resources during the EDR project development period, such as furloughs and hiring freezes, and the potential impacts those restrictions will have on the project, including project delays, reduced revenue collections, unnecessary cost increases, and potential breach of contract issues if we are not able to provide adequate project resources.